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Supreme Court of The United States

OCTOBER TERM 1984

CHEMICAL BANK AND
WASHINGTON PUBLIC POWER SUPPLY SYSTEM,
Petitioners,

v.

PUBLIC UTILITY DISTRICT NO. 1 OF BENTON
COUNTY, WASHINGTON, *et al.*,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF THE STATE OF WASHINGTON

REPLY BRIEF OF PETITIONERS

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1. *Respondents' State Law Justification Defense Fails to Meet the Important Takings Question Presented by This Case.*

It is the principal burden of respondents' argument that the appropriation of a $2.25 billion loan for public use is rendered immune from Federal constitutional scrutiny because it was

sheltered by a state law "substantive ultra vires" doctrine.[1] Respondents stress that that doctrine was designed to protect their constituents from the costs of public projects respondents undertook on their behalf. According to respondents, invocation of that state law purpose is sufficient, without more, to justify total forfeiture of the bondholders' funds.

The decision below achieved precisely the purpose respondents describe: the total protection of local majorities from the costs of public projects. It does not follow, however, that this case involves matters exclusively of state concern—or that granting certiorari here would transform all state court decisions declaring contracts invalid into cases of constitutional dimension. The Takings Clause was adopted to ensure that majorities acting through government would not avoid the costs of public projects by imposing those costs on private parties lacking power to protect themselves. Whether and under what circumstances the "substantive ultra vires" doctrine may be invoked to accomplish that result is the critical Federal takings question presented by this case.

That question arises because of the repudiation by respondents of their "hell or high water" commitments to make all payments necessary for the Supply System to honor the bonds regardless of the success or failure of the projects, and the unforeseeable and arbitrary nature of the decision below that those obligations were "substantively ultra vires"—meaning that the entire debt was cancelled, *nunc pro tunc*, with no obligation even to make restitution of the moneys advanced.[2]

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[1] Three Washington respondents—Franklin County PUD No. 1, Chelan County PUD No. 1 and Douglas County PUD No. 1—have filed statements urging that the petition be granted.

[2] Several respondents suggest in this Court that the decision below was essentially thrust upon them. They say they never "repudiated" their prior commitments. (Washington Public Utilities Group Opp. Br. at 22; Nine Respondents' Opp. Br. at 8; Snohomish Opp. Br. at 6.) For example, the Washington Public Utilities Group claims now that they "believed they had legal authority to enter into such agreements by which they assumed the 'dry hole risk' and have

If respondents were private—instead of public—entities, the "substantive ultra vires" defense would not have been available to them.[3] But if the respondents may avail themselves of this defense because of their governmental status, that same status gives rise to constitutional limitations on the exercise of governmental powers. Particularly is that so where the "State's self-interest is at stake". *United States Trust Co. v. New Jersey*, 431 U.S. 1, 25-26 (1977).

Prior Washington decisions of long standing had taught that the doctrine of "substantive ultra vires" might be used to deny all relief only where "authority is so completely lacking [that] it seems fair to presume bad faith on the part of the private party". *E.g., Noel v. Cole*, 98 Wash. 2d 375, 381 n.3, 655 P.2d 245, 250 n.3 (1982).[4] That rule was ignored in this case. Respondents emphasize their own good faith, stressing that they initiated these projects to meet "their legal responsi-

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never contended otherwise". (Opp. Br. at 7.) But those respondents never made that statement or anything like it in the Court below; they actively sought the result they obtained, and they are obviously now seeking to preserve its benefits. It is therefore not surprising that the Court below concluded that "Respondents have repudiated . . . the participants' agreement". (Appendix A at 35.) And, also contrary to the suggestion of some of the respondents, litigation challenging the validity of the respondents' obligations was initiated by some of the respondents before Chemical filed this declaratory judgment action on behalf of the bondholders. (Petition at 9.)

[3] *See* Brief for the American Bankers Association, *et al.*, as *Amici Curiae* at 12 & n.5.

[4] Many respondents stress the rule that "private parties dealing with a government agency are charged with knowledge of the agency's authority" (citing *Noel*, 98 Wash. 2d at 379, 655 P.2d at 248). But *Noel* and other Washington cases expressly limit the legal consequences of such imputation of knowledge by requiring relief in the absence of bad faith. *See, e.g., Finch v. Matthews*, 74 Wash. 2d 161, 443 P.2d 833 (1968) (relief granted despite unlawful conveyance); *Edwards v. City of Renton*, 67 Wash. 2d 598, 409 P.2d 153 (1965) (recovery awarded on contract held invalid for lack of compliance with procurement and budget statutes); *Abrams v. City of Seattle*, 173 Wash. 495, 23 P.2d 869 (1933) (relief granted despite unauthorized lease agreement).

bility to provide needed electricity to the public".[5] And the Court below itself observed that "all parties assumed that statutory authority existed". (Appendix A at 25.) Its invalidation of the participants' agreements turned not on any blatant or notorious flaw, but rather on such elusive matters as the precise "sufficiency" of control accorded the participants. In such circumstances, the denial of any relief by the imputation of "bad faith" to bondholders constitutes a "totally arbitrary and unprincipled" ruling of the type that many respondents concede is constrained by Federal constitutional guarantees. (Washington Public Utilities Group Opp. Br. at 11.)

There is no plausible regulatory justification that might support the drastic forfeiture of private property effected in this case. Although respondents now see fit to emphasize their asserted lack of "sufficient control", they have not identified even a single act that the Supply System undertook over their objections.[6] The burdens from which respondents seek to insulate their constituents thus bear no relation to the claimed deficiency in their authority. Instead, their constituents' losses stem solely from business risks that respondents themselves concede afflicted the entire industry (*e.g.*, *id.* at 7), risks expressly assumed by the respondents and not shared by the bondholders.

Respondents also seek to defend the denial of all redress on the grounds that (1) they did not receive any of the bondholders' funds; (2) the Supply System expended those funds solely for its own purposes; and (3) respondents received no benefit from the bondholders. These often-repeated claims are without merit. They are an attempt to obscure the substance of the transaction—and therefore the basis of the constitutional claim—by the form of the projects' financing: First, as the briefs in opposition acknowledge, funds flowed

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[5] Washington Public Utilities Group Opp. Br. at 5.

[6] Nor, of course, have they shown why those participants who held 87% of the voting power on the Supply System's Board of Directors did not possess the requisite control, a factor also ignored by the Court below. (*See* petition at 25-26.)

directly to the Supply System (rather than to respondents) only because respondents themselves determined that the Supply System should be used as "the focus for financing". (Washington Public Utilities Group Opp. Br. at 6.) Second, respondents not only concede but emphasize that they initiated these projects to meet their own responsibilities to their own constituents. The Supply System had no such responsibilities; it had no individual constituents; and it had no purposes of its own, other than meeting its obligations to its members (most of whom are the Washington municipal respondents here). Finally, the bondholders plainly conferred a benefit on the respondents: they advanced $2.25 billion in outside financing that enabled respondents to pursue public projects without expending public funds.

Respondents' "substantive ultra vires" defense based on the form of the projects' financing proves far too much because it demonstrates the irrational emptiness of the confiscatory state law theory said to be immune from constitutional scrutiny. The form of the financing transaction, as respondents concede, had nothing to do with the success or failure of the projects. That same form would have applied had the projects been successful. Yet the respondents' "substantive ultra vires" rule invalidates all of their obligations retroactively from their inception. The rule therefore leaves the bondholders without recourse against the respondents no matter what happened after financing of the projects began, as the decision below plainly holds. (Appendix A at 38.)

Still, the respondents argue, the Federal Constitution cannot be implicated because, whether erroneously or not, the Washington Supreme Court approved the repudiation of their obligations. But that approval only consummated a series of actions by participants that, in combination, produced the result the Takings Clause precludes. As was true in *Armstrong v. United States*, 364 U.S. 40 (1960), a series of governmental actions causing a shift in legal relationships, although legally permissible, may place such a substantial and unforeseen

burden on private parties as to constitute a taking requiring compensation.[7]

Finally, there is no merit to respondents' suggestion that application of the Takings Clause here would necessarily effect a massive expansion of this Court's jurisdiction, constitutionalizing virtually every state law contract case. In fact, review and reversal of the decision below would reaffirm the established rule that private property may not be subjected to complete forfeiture by *ipse dixit,* without fair notice and without the justification of a plausible public purpose. *E.g., United States v. Locke,* 53 U.S.L.W. 4433, 4439 n.15 (U.S. April 2, 1985).

2. *Respondents Evade the Due Process Claims.*

Respondents do not attempt to defend the finding of the Court below that the bondholders had been "negligent" in failing to obtain a declaratory judgment regarding respondents' assurances. As set forth in the petition (at 18-19 & n.11), the Court invoked that declaratory action requirement without benefit of any argument or briefing, absent any precedential support, and despite the fact that the bondholders had no binding declaratory judgment remedy.

Respondents seek to label this error harmless by contending that the "substantive ultra vires" holding was sufficient

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[7] In *Armstrong,* a series of transactions by the United States led ultimately to the invocation of a legal defense (sovereign immunity as opposed to ultra vires) that had the effect of destroying an otherwise valuable right (a lien as opposed to a right to restitution). That shift in legal relationships was found to be permissible but to constitute a taking. Here, as there, the sudden destruction of the bondholders' expectations regarding the return of their funds "was not because their property vanished into thin air. It was because the Government for its own advantage destroyed the value of the [property], something that the Government could do . . . but which no private [actor] could have done. Since this [action] was for a public use, however accomplished, whether with an intent and purpose of extinguishing the [property interests] or not, the Government's action did destroy them . . . and did thereby take the property value . . . within the meaning of the Fifth Amendment". 364 U.S. at 48-49. The same conclusion should follow here.

to justify denial of all equitable relief. That simply is not so. The Washington Supreme Court both created this illusory declaratory judgment basis for its decision and attached to it independent significance, repeating it three times. (Appendix A at 25-26, 32.)[8]

Respondents also seek to defend the Court's holding—without benefit of any evidentiary proceeding—that the participants lacked "sufficient control" over their projects.[9] But respondents do not deny that the participants possessed the legal power to control the Supply System through their exercise of 87% of the voting power on its Board of Directors. Instead, they argue that the Court appropriately ignored this unquestioned legal relationship by confining its inquiry to a legal analysis within the "four corners of the agreement".

Respondents do not explain how it could be proper for the Court to limit its inquiry so narrowly as to bar any consideration

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[8] One brief on behalf of the Columbia respondents states that "in cases involving issues of major public importance" Washington courts "have dispensed with the usual requirement of an 'actual case or controversy' ". Opp. Br. at 18, citing a class of cases not relied upon by the Washington Supreme Court. Those respondents neglect to mention, however, that, under Washington law, a discretionary, advisory opinion issued in that class of cases "is not binding on the court in the future and does not determine the rights of any parties . . . ." *In re Elliott*, 74 Wash. 2d 600, 616, 446 P.2d 347, 357 (1968).

[9] It is fantastic to suggest, as do some respondents, that the Court below was straining to invent a new test for the bondholders' benefit under which authority might have been found. Because the Court was construing the Joint Operating Agency statutes (Wash. Rev. Code ch. 43.52) that were enacted to permit participants to contract precisely as they did here—*i.e., without* ownership in the sense of legal title—it was necessary to find something apart from lack of ownership to invalidate the agreements. The decision below amply illustrates the lengths to which the Court was willing to go to find an absence of authority: a result strikingly at odds with that publicly stated by all concerned before the projects failed; a result that was reached by ignoring prior decisions and legislative directions regarding municipal authority; and a result that accordingly was criticized by the three dissenting justices and all commentary. (*See* petition at 10-12 & n.6; Brief for the City of Seattle, Washington, as *Amicus Curiae* at 10-11.)

of legal relationships that should have been dispositive under the Court's own theory of authority. Nor do respondents explain what conceivable public policy might be advanced by a theory of authority that invalidates agreements for lack of "sufficient control" while ignoring contemporaneous legal relationships that establish not merely "control" but complete domination.[10]

Respondents also fail to explain where within the "four corners of the agreement" the Court could conceivably have found a basis for concluding that "the participants' committee apparently served as a rubber stamp for WPPSS' decisions". Nor do they explain how, if the Court confined itself solely to construction of the contract, it could have rested its decision on the ground that "the complexity" of "budgetary items" and "construction decisions" made it "seem unlikely" that "sufficient control" existed. These statements are not the product of contractual construction: they are findings of fact.[11] They were made without the benefit of any trial below. They were maintained despite the bondholders' repeated requests for an opportunity to present evidence. They violate the most fundamental precepts of due process and raise an important Federal question warranting issuance of the writ, as the dissent expressly urged. (Appendix A at 40-41.)

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[10] Certain respondents draw attention to the fact that some participants became members of the Supply System after the participants' agreements were signed. But even those respondents do not deny that the Washington municipal participants—the *only* participants whose authority was at issue here—dominated the Board of the Supply System at all relevant times.

[11] As set forth in the petition (at 25), this was expressly conceded by the very counsel for respondents who now contends that the Court confined its inquiry to the "four corners of the Agreement". (Washington Public Utilities Group Opp. Br. at 27.) The unfairness of these findings is further shown by the fact that they all concerned events occurring after the participants' agreements were signed —events that therefore had nothing whatever to do with the question whether the agreements were "substantively ultra vires" from the time of their inception.

3. *The Pendency of Other Litigation Provides No Basis for Denial of the Writ.*

Several respondents emphasize the pendency of related litigation and suggest it is an alternative means of relief that warrants denial of certiorari here. Respondents fail to note, however, that in those proceedings they vigorously contest the propriety of any such relief; indeed, as their attempts to distance their conduct from the Washington Supreme Court's decision in this case already indicate, they are defending those actions on the grounds that the bondholders' injuries stemmed solely from the decision of which review is sought by the petition. Accordingly, as set forth in the *amicus* brief of the National Bondholders' Committee, the additional lawsuits that respondents stress are not a meaningful or reasonable alternative to review of this central, core case. As in *Logan v. Zimmerman Brush Co.*, 455 U.S. 422, 436-37 (1982), "[s]eeking redress through a tort suit is apt to be a lengthy and speculative process, which in a situation such as this one will never make the complainant entirely whole". That is particularly apparent in the circumstances present here for the reasons set out in the *amicus* brief of the American Association of Retired Persons.

More generally, the respondents' refusal forthrightly to take responsibility for their own conduct illustrates the importance of this case. If this case is permitted to establish an escape route from municipal obligations undertaken in asserted good faith, how many public officials will be able in the future to acknowledge the public's responsibility for the costs associated with unpopular or failed projects? This Court should act now to eliminate the temptation toward municipal irresponsibility created, and the grave injustice perpetrated, by the decision below.

CONCLUSION

For the reasons stated herein, in the petition, and in the *amicus* briefs filed in support of the petition, this Court should issue the writ of certiorari.

Respectfully submitted,

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